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BEFORE THE  
**SURFACE TRANSPORTATION BOARD**

STB EX PARTE NO. 582 (Sub-No. 1)

**MAJOR RAIL CONSOLIDATION PROCEDURES**



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**REPLY OF  
FINGER LAKES RAILWAY CORP.**

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WILLIAM P. QUINN  
ERIC M. HOCKY  
GOLLATZ, GRIFFIN & EWING, P.C.  
213 West Miner Street  
P.O. Box 796  
West Chester, PA 19381-0796  
(610) 692-9116

Dated: June 2, 2000

Attorneys for Finger Lakes Railway Corp.

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**REPLY OF  
FINGER LAKES RAILWAY CORP.**

Finger Lakes Railway Corp. (“FGLK”) files this Reply in response to the comments filed various parties in response to the Advanced Notice of Proposed Rulemaking (“ANPR”) issued by the Board in this proceeding.

**Introduction**

In its initial Comments, FGLK stated that instead of imposing a number of new fixed conditions, the Board should instead require realistic, specific disclosures by applicants of how the applicants will handle different relevant issues. *See FGLK* at 2.<sup>1</sup>

As a Class III carrier, FGLK is interested in the Comments pertaining to the treatment of shortlines in a proposed merger. Most of the Class I submissions conclude that shortline issues are a matter to be resolved through private negotiation. FGLK is in general

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<sup>1</sup> Unless otherwise noted, references are to the comments filed by the designated party in response to the ANPR.

agreement with this concept so long as both parties exercise good faith in attempting to resolve the issues. For this reason FGLK continues to believe that the Board should only consider imposing conditions when the parties cannot agree on the ways to promote the public interest. In reviewing several of the Comments of the parties to this proceeding, it is interesting that many of the carriers have openly speculated about various options for dealing with many of the issues raised by the Board. FGLK believes that this is a representative sampling of private sector ideas that, if they were proposed by the applicants in a merger application, might well be wholly agreeable to affected parties. For this reason FGLK continues to believe that the Board should only consider imposing conditions when the parties cannot agree on the ways to promote the public interest.

The Class I carriers in their comments have openly speculated about various options to deal with many of the issues raised by the Board in the ANPR. These Comments demonstrate that, if the Board were to require applicants to discuss "critical issues" in their application submission, they will respond with creative solutions. The responses to these issues can then be used by the Board as the basis for evaluating whether the expected impact of the transaction is in the public interest and whether conditions should be imposed.

The following represent a sampling of ideas from Class I Comments that, if proposed by the applicants in a merger application, might well be wholly agreeable to affected parties:

#### Merger Planning & Implementation

NS: Because of the critical importance of actual rail traffic data in performing sound merger-impact analyses and the time-intensive nature of such studies, Norfolk Southern recommends that the Board adopt a rule requiring prospective major rail consolidation applicants to make their 100 percent traffic tapes available to qualified parties (subject

to an appropriate protective order) as soon as practicable after the filing of a notice of intent to file a major rail consolidation application. This would permit interested parties to begin their own independent merger-impact analyses, and to formulate their own positions on the proposed application, before it is actually filed. Such pre-application access to critical traffic data would minimize pressures to extend the "default" procedural schedule and enable parties to prepare and present to the Board better merger-impact testimony.

*NS* at 67.

[Note: NS's comment regarding traffic data reminded FGLK of another issue that the Board may want to visit - the deadline for shipper selection in the routing of its freight under contract. In the partitioning of Conrail (FD 33388), shippers were allowed to select contract routing options up to the split date. FGLK understands that many waited until a day or two before the split date to make their decision. FGLK believes that this was problematic in that neither split carrier knew the volume and routing of the traffic it would actually be handling on the split date. This can significantly impact service at locations where more traffic will be handled than expected (yards and interchange points). The Board may want to consider a deadline for shipper routing selection of contract or "bottleneck" resolutions well ahead of the merger implementation date in its approval of future transactions. This would allow the merger applicants and other affected rail carriers adequate time to evaluate any changes that may be required in operations and infrastructure to accommodate the actual traffic flows.]

#### Consideration of merger impacts on shortline and regional railroads

NS: Norfolk Southern and the other major railroads have a strong interest in promoting and development of viable short-line and regional railroads whose operations are supported by market conditions. It is therefore entirely appropriate that the Board, in assessing the effects of a proposed major rail consolidation, consider potential adverse impacts of

the transaction on smaller rail carriers – just as it should consider possible adverse affects on large railroads, shippers, employees, public authorities and any other affected parties. In this regard, there is nothing unique about short-line and regional railroads.

*NS* at 53-54.

CPR: In particular the Board should articulate a policy that looks favorably upon creative strategic partnerships among connecting carriers.

*CPR* at 6.

### Shortline Service Issues

UP: UP indicates that Class III rail carriers would be treated the same as shippers in considering remedies for deteriorated service reimbursement. *See UP* at 9.

CSXT: The application shall list all Class III carriers (and all rail carriers in Canada which are not transcontinental carriers) (collectively, "shortlines") with which the lines of any of the applicants directly connect, shall describe the principal lines of each such carrier, shall identify the points of connection between the applicants and each such shortline, and shall identify what, if any, other rail carriers connect with the lines of the shortlines and the points of connection. Applicants shall consult with each directly connecting shortline during the period subsequent to the Notice of Intent as to operational matters. After the filing of the application, Applicants shall provide each directly connecting shortline with a copy of the Operating Plan, Integration Plan, Capacity Plans and Rolling Stock Supply Plan and shall name one or more individuals as Applicants' contact person to address questions raised by such short lines regarding the Plans.

*CSXT* at F1.

### Preservation of gateways and rate challenges

UP: UP states that it is willing to include an exclusively served Class III carrier as part of its segment rate proposal to mitigate "bottleneck" issues that could occur as a result of a merger transaction. *See UP* at 12-13.

NS: Norfolk Southern suggests that this proposed gateway protection policy be implemented by requiring major rail consolidation applicants to establish, upon reasonable request by eligible solely served rail shippers, a common carrier or contract rate to apply to the movement of the shipper's traffic over the merged carriers' lines to/from a covered interchange point for use in conjunction with another railroad not involved in the proposed consolidation. The shipper would then be free to interchange its traffic with another connecting rail carrier at that connection and to use interline transportation service to complete the shipment. If the affected shipper were dissatisfied with the rate offered by the merged system, the shipper could bring a complaint seeking prescription of a reasonable rate to apply to the movement. This mechanism would have the effect of preserving the competitive routing options that existed pre-merger, and preventing the merger from extending the scope of the "bottleneck."

*NS at 38.*

KCS: KCS has suggested that the burden be on the applicants to disclose and justify that keeping the facility, station or terminal closed was substantially in the public interest.

*See KCS at 61.*

#### Paper and Steel Barriers

CSXT: The applicants may not enforce any such agreement in any way that has the effect of providing that the reach of such Blocking Provision is expanded as a result of the transaction.

*CSXT at C3.*

KCS: KCS has proposed that the applicants be required to submit a list of agreements which contain blocking provisions for which the applicants must discuss the underlying rationale, whether the provision should be removed and analyze how removal of the provision would impact the proposed transaction. *See KCS at 84.*

## Car Supply

CSXT: A similar Capacity Plan for rolling stock shall be made with respect to fleet requirements of locomotives and freight cars and the proposed capital budget for them. The material concerning rolling stock required by § 1180.8(a)(3) shall be integrated and submitted as part of the Capacity Plan for rolling stock contemplated hereby. The Board may appoint consultants at the expense of the applicant to assist the Board's staff in its review of these plans.

(iii) A rolling Stock Supply Plan addressing both locomotives and cars. The Supply Plan should be complementary to the rolling stock Capacity Plan. The Supply Plan for cars should also discuss principles for allocating cars in time of shortage. The Board may appoint consultant at the expense of the applicants to assist the Board's staff in its review of the plans.

CSXT at E5.

## Merger Alternatives - Alliances

FGLK supports the NS contention that alliances rather than mergers can be just as effective in improving service, reducing costs, and increasing business opportunities. Alliances, as NS points out from its own experience, can be difficult to negotiate, and the process of monitoring the agreements, assigning responsibility for service deficiencies, and enforcing the necessary level of cooperation between the carriers can be used as an excuse for failure. Nevertheless (and especially with end-to-end mergers), alliances can be implemented quickly and the alleged benefits of merger can be confirmed. If a better alliance surfaces, shippers will reap additional benefit.

Similarly KCS also has found value in alliances. In its initial Comments, KCS said, "The Alliance Agreement clearly established a major third option for rail shippers moving traffic between Canada and Mexico, and between the Midwest and Southwest and points in between.

Through these private agreements, the benefits of improved coordination and "single-line-like" service can be realized far short of merger." KCS at 19.

Another avenue that could be pursued with an alliance arrangement would be market swaps or reciprocal market access programs. For example, there are "Chinese walls" at gateway locations such as St. Louis and Chicago, where obtaining competitive rates from the western carrier on an eastbound move and vice versa, are extraordinarily difficult. The carrier with the "short haul" does not want to devote management time, equipment or improved services for a low revenue movement. As a result, trucks prosper and the public interest benefit of effective rail competition suffers because of the railroad's indifference. An alliance that provided a simple arrangement of haulage, with the responsibility for car hire and "loss and damage" resting with the longer haul carrier, could benefit both railways.

### **Infrastructure & Capital Needs**

In reviewing a number of the initial Comments of Class Is and others, there is a recurring theme regarding the extensive future capital needs of merging carriers. KCS points out that the capital needs of shortlines are equally as important and as much as an issue as those of Class Is:

More importantly, lines purchased by smaller railroads frequently suffer from maintenance deferrals by their former Class I owners. Reviewing these and other pertinent facts, the AASHTO Study projected a shortfall of between \$6.11 and \$9.5 billion over the next 10 years in shortlines' ability to meet their capital needs.

This projected massive shortfall in shortlines' ability to meet their capital needs runs dangerously counter to the increasing importance of shortlines in maintaining intramodal rail competition. The shortline and regional railroad industry as a whole clearly will not be able to fulfill its role of offsetting the drop



in competition among Class I's if the industry cannot generate the revenues needed to maintain its lines.

*KCS* at 89 (footnotes omitted).

In a related footnote, *KCS* further states "This situation, indeed, bears many similarities to the situation of major railroads at the time of the Staggers Act. Congress' response in that situation was to lift restraints on competition to promote major railroads' financial health. Removing paper and steel barriers could have similar effects for smaller railroads." *KCS* at 89 n.39.

#### Property Tax Issues

FGLK discussed the impact of property tax issues in its Comments. *FGLK, Smith VS* at 30. While the Board may lack specific authority to prescribe remedies in inequitable situations, it should acknowledge that property taxes can influence the crafting of a merger and can promote inefficient and ineffective investment or divestment at a time when capital expenditures by railroads must be cost effective.

#### Rule Recommendations

In its initial Comments FGLK did not suggest specific language with respect to rules. Based upon its own initial Comments and the Comments of other parties, FGLK now believes it is in a position to suggest some specific regulations as set forth below, and to support some specific regulations set forth by other parties in their Comments.

### Pre-Merger Versus Post-Merger Service Benchmarks

FGLK notes that many of the Class I submissions included reference to improved standards for merger implementation and in particular better measurement of the proposed service offerings. FGLK's initial Comments asked for consideration of specific service benchmarks to be used in evaluating the service offering, both pre- and post-merger. *See FGLK, Smith VS* at 17. This would also establish the base case from which any claim of injury due to deteriorated service is measured. FGLK recommends that the Board amend 49 C.F.R. 1180 to require these benchmarks as part of the applicants' operating plan, as set forth in Appendix A.

FGLK also believes that the consideration of service performance be an integral part of Board oversight authority, and as suggested by BNSF, that the Board should amend 49 C.F.R. 1180.4(c)(6) to provide for a 5 year oversight period following the approval of all Class I railroad mergers. *See BNSF* at 46.

### Application Requirements

FGLK has suggested that the Board establish the merger issues that applicants would be required to address in their application. *See FGLK, Smith VS* at 9. Their responses to these issues would form a basis for the Board to evaluate the application to determine if the transaction is in the public interest. The Board can then weigh the responses of other parties to determine if imposition of a condition is warranted. A proposed addition to 49 C.F.R. 1180 is set forth in Appendix A.

### Merger Review Team

In its initial Comments, FGLK asked the Board to consider a "Merger Review Team" that would review the proposed operating plan and service benchmarks. *See FGLK, Smith VS* at 17. FGLK believes that an on site review is important to provide the Board and the public interest it protects, a high level of assurance that the plan can be implemented without significant adverse impact to other stakeholders. Other parties, including CSXT (*CSXT* at 12-13) and Congressman Jerold Nadler (*Nadler* at 4-5), suggested that the Board consider retaining an outside consultant (at applicants' expense) to review the operating plan. While this would not provide the same variety of viewpoints as the proposed Merger Review Team would, FGLK believes it is a valuable and concrete recommendation that should be seriously considered by the Board. A proposed regulation on the establishment of the Merger Review Team is attached as part of Appendix A.

**Conclusion**

FGLK requests that the Board amend its major rail consolidation guidelines consistent with the recommendations set forth herein and with FMRS's initial Comments.

Respectfully submitted,



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WILLIAM P. QUINN  
ERIC M. HOCKY  
GOLLATZ, GRIFFIN & EWING, P.C.  
213 West Miner Street  
P.O. Box 796  
West Chester, PA 19381-0796  
(610) 692-9116

Dated: June 2, 2000

Attorneys for Finger Lakes Railway Corp.

# VERIFICATION

I, Michael V. Smith, President of Finger Lakes Railway Corp., verify under penalty of perjury that the foregoing Reply is true and correct. Further, I certify that I am qualified and authorized to file the foregoing Reply.

Executed on June 2, 2000.

A handwritten signature in black ink, consisting of a stylized 'M' followed by a checkmark-like flourish and a diagonal line.


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Michael V. Smith

**CERTIFICATE OF SERVICE**

I hereby certify that on this date a copy of the foregoing Reply of Finger Lakes  
Railway Corp. was served by First Class Mail, Postage Prepaid, on all Parties of Record.

Dated: June 2, 2000

  
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ERIC M. HOCKY

## **APPENDIX A**

## **Proposed Regulations**

### **Benchmarks**

Amend 49 C.F.R. 1180 to provide:

Applicants shall submit an operating plan that contains benchmarked service standards. Applicants will identify the pre-merger mean transit times on a major city basis (including connecting shortlines), individually by traffic sectors (intermodal, merchandise and unit train rail car business). The applicants will propose post-merger mean transit times, and compare the differences between pre- and post-merger service. The applicants will then address any departure from pre-merger service levels. This submission shall include the “through schedules” of other connecting Class I railroads. Service between major yard terminals and connecting regional and shortline railroads will be identified and submitted in the same form as the major city information.

### **Application Requirements**

Amend 49 C.F.R. 1180 to provide:

The applicants will, in a separate section of their application, respond in detail as to their policy and intent in treating the following issues:

- What specific benefits do the applicants expect to derive from consummating the proposed transaction, and what benefits are in the public interest?
- How do the applicants intend to protect customers and shortline railroads from transaction-related service disruptions, and the loss of adequate infrastructure and capacity?
- What performance standards do the merger applicants intend to meet, and what is the service integration plan detail?
- How will the applicants approach gateway issues for all major routings?



- To what extent does the applicants' proposal provide switching, at agreed-upon fees, to all exclusively served shippers located within or adjacent to terminal areas?
- How will the applicants approach the competitive portion of joint-line routes when the joint-line partner has a bottleneck segment?
- How will the applicants handle routing at a reasonable interchange point whenever they control a bottleneck segment and the shipper has entered into a contract with another carrier for the competitive segment?
- How will the applicants provide an exclusively served shipper with access to an additional carrier where the solely serving carrier is merging with one of several connecting carriers?
- What is the applicants' policy with respect to compensation of shippers and shortlines for demonstrable costs of service failures?
- What is the applicants' policy with respect to so called "paper" and "steel" route barriers in connection with shortline and regional railroads?
- What interchange and routing freedoms will the applicants grant shortline and regional railroads?
- What steps have the applicants taken to assure competitive and nondiscriminatory pricing with respect to shortline and regional railroads?
- What is the applicants' policy with respect to nondiscriminatory car supply involving shortline and regional railroads?
- How will the applicants deal with post-transaction changes in collective bargaining agreements and/or expanded labor protection?
- How will merger applicants handle those situations where the number of rail carrier alternatives within a corridor would be reduced by this transaction from three to two?

- To the extent the proposed transaction involves cross-border parties, how will the applicants address adequacy, consistency, and effectiveness of extra-territorial oversight, safety matters, national defense implications of foreign control of a large U.S. railroad, impacts on U.S. ports and waterway systems, and impacts on U.S. grain and lumber interests?
- Does adequate car supply exist to support the projected business volumes of the applicants' plan?

### **Merger Review Team**

Amend 49 C.F.R. 1180 to provide:

Upon the filing of a Notice of Intent by applicants to consummate a major transaction under 49 C. F. R. 1180.2, the Board will appoint a merger review team (paid for by applicants) to be activated on the date of filing. The review team will be comprised of representatives of shippers, shortlines, and other potentially affected parties. The review team will carefully scrutinize the application, as directed by the Board, and advise the Board of their findings no later than 180 days from the date of filing.